BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
ROBERT C. AND VERNELL MEGLASSON)

For Appellants: John H. Rosenfeld
Attorney at Law

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Robert C. and Verne11 Meglasson against a proposed assessment of additional personal income tax in the amount of $9,856.90 for the year 1974.

On June 5, 1974, appellants entered into a certain Contract for Sale of Real and Personal Property (hereinafter referred to as "the Contract") with Suzanne Hawkins, dba Hayden Livestock Company (hereinafter referred to as "Buyer") for the sale of three parcels of real property and certain items of personal property. The total sales price of $340,000 was apportioned in the Contract between the real and personal property as follows: $36,000 for the residence property (Parcel 1); $270,000 to the balance of the real property (Parcels 2 and 3); and $34,000 to the personal property.

Pursuant to the terms of the Contract, Buyer made payments totaling $125,000 in the year of the sale; additional payments in 1974 were specifically prohibited without first obtaining appellants" prior written consent. The Contract did not provide for the manner in which the payments effectuated in 1974 were to be allocated between the real and personal property. Appellants contend, however, that at the time of the sale there existed an agreement with Buyer that of the $125,000 to be paid in 1974, $34,000 would be applied in full payment of the personal property and the balance of $91,000 would be applied to the sales price of the real property. In this manner, appellants explain, they would receive only 29.74 percent of the sales price for the realty in the year of the sale ($91,000 ÷ 306,000 = 29.74%) and would thereby qualify, pursuant to section 17578 of the Revenue and Taxation Code, to report the gain thereon under the installment method.

Respondent denied appellants use of the installment method for purposes of reporting the gain from the sale of the real property. Noting that the Contract did not provide for allocation of the first year payments between the real and personal property, respondent allocated the $125,000 received in 1974 between the realty and personalty on a pro-rata basis, based on their respective sales prices. Since Revenue and Taxation Code section 17578 provides that gain from the sale or other disposition of real or personal prop-. erty may be reported under the installment method only when payments during the year of sale do not exceed 30 percent of the selling price, and because the $125,000 received in 1974 constituted more than 30 percent of the total sales price of $340,000, respondent concluded that appellants were ineligible to report the gain from their sale under the installment method.

Respondent has set forth two arguments challenging appellants' use of the installment method for purposes of reporting gain from the sale of the real property. Initially, respondentcontends that at the time of the sale there existed no agreement between appellants and Buyer to the effect that $34,000 of the total first year payments of $125,000 would be allocated to full payment of the personalty with only the remaining balance of $91,000 to be allocated to the sales price of $306,000 for the realty. Additionally, respondent contends that even if such an agreement did exist, appellants did not qualify to report the gain from the sale of the realty under the installment method because the agreement was not set forth in the Contract.

The first question presented for our determination is whether the alleged agreement had to be set forth in the Contract. The secondary issue of whether such an agreement existed at the time of sale arises only if it is determined that it need not have appeared in the Contract.

Citing Bar-Deb Corp. v. U.S., 36 Am.Fed.Tax R.2d 75-5893 (1975), respondent contends that any agreement regarding the allocation of first-year payments between multiple assets must appear in the contract for sale when more than 30 percent of the total sales price for all assets is received in the year of sale; when such an allocation of first-year payments is not provided for in the contract, respondent argues, the taxpayer may not take advantage of the installment method. After reviewing the above cited case and the other authorities relied upon by respondent, we are of the opinion that the alleged agreement pertaining to the allocation of the first-year payments did not have to appear in the Contract.

Contrary to repondent's reading of the holding in Bar-Deb Corp. v. U.S., supra, we do not believe that the issue in that case was whether a seller could establish the existence of an agreement relating to the allocation of first-year payment when such an understanding did not appear in the contract for sale. The court in Bar-Deb decided an issue distinguishable from the one here, i.e., that the vendor of a business could not split the business into '"goodwill" and "operating assets" so as to allocate payments between the two. The sale, the court held, was "a single transaction involving the sale of and [sic] entire business as a going concern." (Bar-Deb Corp., supra, at p. 75-5897.)

We are aware of no authority, nor has respondent presented us with any, which requires that the agreement pertaining to allocation of first-year payments appear in the Contract in order for appellants to qualify to report the gain on the sale of the realty under the installment method. What authority does exist impliedly recognizes that such an allocation agreement need not appear in the contract for sale, but merely that it exist at the time of sale. (See James A. Johnson, 49 T.C. 324 (1968); Andrew A. Monaghan, 40 T.C. 680 (1963); Rev. Rul. 68-13, 1968-l Cum. Bull. 195.)

Having concluded that the alleged agreement need not have been expressly set forth in the Contract, we must now determine whether, at the time of sale, there existed an agreement between the parties to the Contract that the first-year payments were to be allocated in such a manner as to insure that appellants would be able to report the gain from the sale of the realty under the installment method.

Appellants, while acknowledging that the Contract did not provide for the allocation of first-year payments between realty and personalty, nevertheless maintain that there is ample evidence demonstrating that such an agreement existed. The evidence presented by appellants consists of: (i) working papers of appellants' attorney at the time of the sale showing how the payments received 'in 1974 were to be allocated between the realty and personalty; (ii) the Contract provision prohibiting Buyer from making first-year payments in excess of $125,000 which, appellants contend, was designed to prevent Buyer from paying more than 30 percent of the sales price of the realty; (iii) an affidavit from Buyer, obtained especially for purposes of this appeal, in which Buyer attests that at the time of the sale she understood and intended that of the $125,000 paid to appellants in 1974, $34,000 was to be allocated to full payment of the personal property and the balance of $91,000 was to be allocated to the realty; and (iv) appellants' delivery to Buyer in November 1974 of a Bill of Sale in which they acknowledged full payment of the sales price of the personal property in the year of the sale.

Respondent, while ignoring the Contract provision prohibiting payments in excess of $125,000 in 1974, has questioned the credibility of the affidavit, the Bill of Sale, and the working papers of appellants' attorney. To support its argument that these documents

lack credibility, respondent has devised the following scenario:

> The information furnished by appellant[s] can fairly be interpreted that after the sale the attorney was asked about installment reporting of the sale. He prepared his "notes" [a reference to the working papers] to show how the first year payment should be allocated. Six months later, a bill of sale on the personal property was furnished the buyer to support the attorney allocation. Further, after the proposed assessment was issued appellants prevailed upon the buyer to set forth in an affidavit appellants' purported intention to allocate the first year payments. This affidavit was prepared six years after the sale.

After carefully reviewing the record on appeal, we are convinced that respondent's above-reproduced reconstruction of the events in issue is without factual foundation and that at the time of the sale there existed an agreement between appellants and Buyer to allocate the first-year payments in such a manner that appellants would qualify to report the gain from the sale of the realty under the installment method.

The Bill of Sale was delivered to Buyer soon after the second, and final, first-year payment was received by appellants. As such, it constitutes compelling evidence, resulting from actual performance of the Contract, that the two parties intended $34,000 of the $125,000 first-year payments to be allocated to full payment of the personalty. Accordingly, appellants' delivery of the Bill of Sale supports their contention that an agreement regarding the allocation of first-year payments, as described by appellants, existed at the time of the sale.

The Contract provision prohibiting Buyer from making payments in excess of $125,000 in 1974 also constitutes evidence as to the existence of the subject agreement. Had Buyer been allowed to make payments in excess of that amount, such additional payments would have been allocated to the sales price of the realty as the full sales price of the personalty had already been paid. Even an additional $1,000 in payments would have been sufficient to deny appellants the alternative of reporting gain from the sale of the realty under the

installment method as they would have then received more than 30 percent of the purchase price for the realty in the year of sale. Respondent has given no alternative explanation for this Contract provision nor are we aware of any reasonable explanation. It stretches credulity to accept as mere coincidence that the $125,000 in first-year payments, after full payment of the personalty, constituted 29.74 percent of the selling price for the realty.

Finally, the working papers and affidavit also support appellants' contention as to the existence of the aforementioned agreement. The confluence of all these factors leads to the inescapable conclusion that the parties to the Contract intended and agreed, at the time of sale, that the first-year payments would be allocated in the manner described by appellants. Consequently, as appellants received less than 30 percent of the sales price of the realty in 1974, respondent improperly determined that appellants did not qualify to report the gain from the sale of the realty under the installment method.

For the reasons set forth above, respondent's action in this matter will be reversed.

Appeal of Robert C. and Verne11 Meglasson

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Robert C. and Verne11 Meglasson against a proposed assessment of additional personal income tax in the amount of $9,856.90 for the year 1974, be and the same is hereby reversed.

Done at Sacramento, California, this 27th day of October, 1981, by the State Board of Equalization, with Board Members Mr. Dronenburg, Mr. Bennett and Mr. Nevins present.

Ernest J. Dronenburg, Jr., Chairman

William M. Bennett, Member

Richard Nevins, Member

_____, Member

_____, Member